



OFFICE OF ADVOCACY

A VOICE FOR SMALL BUSINESS

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Compensation by Handshake Not by Lawsuit

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Right now, hundreds of thousands of small business owners have difficulty trying to determine which of their employees should be paid overtime. This is because the current Federal rules implementing the law's overtime pay requirement are so confusing that few fully understand what is required without the assistance of legal counsel. The current overtime rules, written for "key punch operators" and "straw-bosses" 50 years ago, just have not kept up with the changing workplace. "Exempt" white collar employees, such as management and other professional or administrative employees, are not automatically entitled to overtime, and employers who make a mistake in deciding who is an exempt white collar employee can be sued for three years worth of back pay. The U.S. Department of Labor is trying to help clear the confusion by updating and simplifying the rules for the 21st century. When the public was asked to comment on the Labor Department's updates, critics claimed that updating the rules will result in the loss of overtime wages. As head of a federal office charged with independently speaking out for small business, here is a perspective that should shed some light on the overtime rules.

In 1938, Congress guaranteed workers the right to overtime pay for more than 40 hours of work per week. This right to overtime pay has helped to make sure that employers do not force employees to work endless hours. Because management decides who works overtime, Congress excluded management from the overtime pay requirement along with other professionals and administrative employees. After years of changes in job descriptions and workplaces, the current rules are difficult to apply to managers.

The U.S. Department of Labor is responsible for setting rules defining who is and is not an “executive,” “administrative,” or “professional” employee, and therefore exempt from the workers’ overtime pay requirement. The Department of Labor’s current rules tell employers that an employee is exempt from the overtime requirement if the employee is paid a certain minimum salary (the “salary test”) and performs specific duties (the “duties test”). The problem is the “salary test” has not been updated for inflation in more than 20 years, and the “duties test” is long, complex, and confusing.

What is worse is that running afoul of this dated and confusing rule has some serious consequences. Employers who misinterpret the “duties test” and are sued could not only wind up paying three years worth of back overtime pay to a particular employee, but they may be forced to reclassify an entire set of employees and pay fines or back pay for them as well. The result is that losing an overtime lawsuit can easily put a small family business into bankruptcy.

Since the “duties test” does not have an objective set of criteria, and the consequences of misinterpretation are so harsh, businesses that can be sued for back overtime pay likely settle without a fight. Small business owners want to hire and keep valued employees. They do not want uncertainty that is bred into a system where employment decisions and salaries are determined through lawsuits.

In 2003, the Department of Labor began the process of updating and clarifying the rules governing overtime decisions. Estimates are that the revised rule will cost U.S. small businesses \$502 million to \$836 million. That is because the rule would make 1.3 million low-income employees immediately eligible for mandatory overtime pay by increasing the “salary test” level. However, the definition of who is and is not an exempt employee, such as an executive, will be updated so that small businesses can avoid the litigation nightmare that arises from misinterpreting and misapplying the current rule. Small business associations from a diverse array of industries, representing restaurants to retailers, are supportive of this rule even though small business owners may pay more in overtime because those costs are minimal compared to the costs of litigation under the current system.

It is unfortunate that some people are attempting to block this change and are favoring an employment fairness system that relies on costly litigation instead of up-to-date guidance. Small business owners and their employees deserve an overtime rule that makes sure the appropriate workers are paid overtime, and which makes it easy to determine who is and is not an executive, professional, or administrative employee. The Department of Labor should be allowed to modernize overtime pay regulations for the 21st century.

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